

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF MEADE COUNTY)	
RURAL ELECTRIC COOPERATIVE)	
CORPORATION FOR AN AMENDMENT TO)	CASE NO.
PRIOR ORDERS OF THE COMMISSION)	92-324
AUTHORIZING ISSUANCE OF EVIDENCE)	
OF INDEBTEDNESS)	

O R D E R

On July 31, 1992, Meade County Rural Electric Cooperative Corporation ("Meade County") filed a request that the Commission amend its prior Orders entered in Case No. 6444,¹ Case No. 6805,²

¹ Case No. 6444, Application of Meade County Rural Electric Cooperative Corporation for an Order Authorizing Said Corporation to Borrow \$642,000.00 from U.S.A., and the Sum of \$276,000.00 from National Rural Utilities Cooperative Finance Corporation for the Purpose of Serving 745 New Customers to Construct Lines, to Convert Lines, and for System Improvements, and to Purchase from National Rural Utilities Cooperative Finance Corporation Capital Term Certificates in an Amount Equal to 5% of C.F.C. Loan, Order dated January 30, 1976.

² Case No. 6805, Application of Meade County Rural Electric Cooperative Corporation for an Order Authorizing Said Corporation to Borrow \$670,000.00 from U.S.A., and the Sum of \$287,000.00 from National Rural Utilities Cooperative Finance Corporation, for the Purpose of Extending Service to New Customers, to Build Lines, to Convert Lines, and for System Improvements, and to Purchase from National Rural Utilities Cooperative Finance Corporation Capital Term Certificates in an Amount Equal to 5% of CFC Loan, Order dated June 7, 1977.

Case No. 8431,³ Case No. 9634,⁴ and Case No. 89-119⁵ to authorize the conversion from a fixed to a variable interest rate for National Rural Utilities Cooperative Finance Corporation ("CFC") Loan Nos. 9005, 9007, 9015, 9016, and 9017. The terms of these 35-year loans originally provided for a fixed interest rate for the first 7 years, after which, the rate would be renegotiated. Since the execution of these loans, interest rates have been substantially reduced and CFC has allowed borrowers to convert to a reduced variable interest rate. The current fixed interest rate for these loans is 9.5 percent, 8.5 percent, 8.75 percent, 8.75 percent, and 9.5 percent, respectively. The variable rate applicable for these loans is 5.5 percent. On July 23, 1992, Meade County's board of directors voted to convert to the variable rate.

³ Case No. 8431, The Application of Meade County Rural Electric Cooperative Corporation for an Order Authorizing Said Corporation to Borrow \$1,182,000 from U.S.A., and the Sum of \$533,000 from National Rural Utilities Cooperative Finance Corporation for the Purpose of Serving 1,400 New Customers to Construct Lines, to Convert Lines, and for System Improvements and to Purchase from National Rural Utilities Cooperative Finance Corporation Capital Term Certificates in an Amount Equal to 5 Percent of C.F.C. Loan, Order dated January 21, 1982 and amended July 29, 1983.

⁴ Case No. 9634, Application of Meade County Rural Electric Cooperative Corporation Requesting Commission Approval of a Certificate of Convenience and Necessity to Construct Additional Plant and Extensions and Approval to Issue Securities from the National Rural Utilities Cooperative Finance Corporation, Order dated September 16, 1986.

⁵ Case No. 89-119, The Application of Meade County Rural Electric Cooperative Corporation Requesting Commission Approval of a Certificate of Public Convenience and Necessity to Construct Additional Plant and Extensions and Approval to Issue Securities from the National Rural Utilities Cooperative Finance Corporation, Order dated August 11, 1989.

When converting from the fixed rate program to the variable rate program, CFC requires the payment of a conversion fee. The conversion fee for each loan is based on the difference in the interest rate on the note and CFC's long-term interest rate at the time the borrower elects to convert to the variable rate. The difference is applied to the outstanding loan balance at the start of the borrower's next first full quarterly billing cycle for the time remaining until a repricing option would have been allowed. A one-time, up-front fee of 25 basis points on the outstanding balance at the time of conversion is added to the conversion fee. The conversion fee could be paid either in quarterly payments or as a discounted up-front payment. The total conversion fee would be \$118,356 if paid quarterly and \$103,083 if paid up-front.

Meade County provided a series of Internal Rate of Return ("IRR") analyses for each loan it proposed to convert. Under the IRR approach, the goal of the borrower would be to utilize the interest rate program which produces the lowest IRR. For each loan, Meade County determined an IRR value for the following three different scenarios:

1. The current variable rate remained constant for the remainder of the pricing cycle ("Scenario I").
2. The current variable rate would begin increasing by .25 percent each quarter, beginning with the second quarter after conversion, for the remainder of the pricing cycle ("Scenario II").

3. The third scenario involved determining the variable interest rates which, when applied beginning with the second quarter after conversion, would result in an IRR value approximately equal to the IRR value resulting from the current fixed interest rate. Meade County considered this the break-even scenario.

Each scenario was run twice showing the impact on the IRR value of each payment option chosen for the conversion fee.

The analysis indicated that, under either Scenario I or II, the resulting IRRs for the variable interest rate generally were lower than the IRR for the fixed interest rate. The scenario results also indicate it is beneficial to Meade County to pay the conversion fees up-front rather than quarterly. Scenario I resulted in a net cumulative savings of \$128,136 when the conversion fees were paid up-front and \$112,863 when the conversion fees were paid quarterly. Scenario II resulted in a net cumulative increase in costs, regardless of whether the conversion fees were paid up-front or quarterly. One of the assumptions in Scenario II was the constant increase in the variable interest rate, starting in the second quarter after conversion. For two of the five loans, net savings were projected for the entire pricing cycle. For the other three loans, net savings were projected to occur through at least the first nine quarters of the current pricing cycle. However, these three loans had 14 or more quarters remaining in the current pricing cycle. For those loans, the escalating variable

interest rate approached or exceeded the current fixed rate over the remaining pricing cycle.

In its request, Meade County indicated that it would pay the conversion fees using the quarterly payment option. Meade County stated that the effective interest rate on the conversion fee would be under 5 percent. As it is paying more than 5 percent on loan funds and assumes that interest rates will rise, Meade County has determined that the quarterly payment option is its best option. Meade County stated that it did not see any indication of significant increases in the variable interest rate in the near future. Meade County indicated that it intended to constantly monitor the variable and fixed interest rates, and at whatever time indicators show it to be advantageous, lock into a fixed interest rate.

Based upon its review of the record and being otherwise sufficiently advised, the Commission finds that the conversions of the five loans should result in interest savings on an IRR basis and that the loans should be converted as requested.

IT IS THEREFORE ORDERED that:

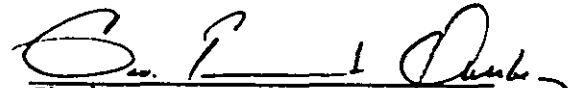
1. The Commission's Orders entered in Case Nos. 6444, 6805, 8431, 9634, and 89-119 be and they hereby are modified to authorize the conversion from a fixed to a variable rate program for CFC Loan Nos. 9005, 9007, 9015, 9016, and 9017. In all other respects, the Commission's Orders entered in Case Nos. 6444, 6805, 8431, 9634, and 89-119 shall remain in full force and effect.

2. Meade County shall notify the Commission of the closing date of the conversions and shall file, within 30 days of the conversions, all documents pertaining thereto.

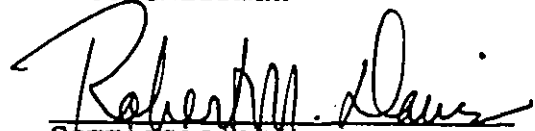
3. Meade County shall file, along with its monthly financial report to the Commission, the current interest rate on its variable rate loans outstanding.

Done at Frankfort, Kentucky, this 28th day of August, 1992.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:


Executive Director